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Date:  
December 11, 2012

Entity:

Company:

State:

Agreement:

Agent:

Date:

Dear :

This letter responds to a letter from your authorized representative signed August 31, 2012, submitted on behalf of Entity and Company (the Taxpayers), requesting a ruling that Company's income will be excluded from gross income under § 115 of the Internal Revenue Code. The Taxpayers represent the facts as follows.

**FACTS**

Entity was created and is operated under State law as an agency of State. Its purpose is to provide professional investment management of various trusts and operating funds established under the laws of State. Entity has broad authority to invest and reinvest, to collect income and rents, to acquire, manage, and sell real estate, and to employ outside counsel and contractors.

Entity formed Company on Date as a limited liability company under the laws of State. Entity is the sole member of Company. The Agreement provides that as long as Entity is a member of Company, no party other than a state, a political subdivision of a state, or an entity whose income is excluded from gross income under § 115 may be admitted as a member of Company.

Agent is the initial manager of Company, with the duties and authority as specified in the advisory agreement between Agent and Company, as limited or otherwise modified by the Agreement. Entity may select any legal entity to serve as a successor manager under an advisory agreement to be reached between the successor and Company. Entity may remove Agent or any successor manager at any time, with or without cause.

Company's purpose, as stated in the Agreement, is to invest in certain commercial real estate loan transactions for Entity (in other words, to act as a lender). Entity will contribute capital to Company, allowing Company to invest in commercial real estate loans. Each loan will be made to an unrelated third-party borrower and will be documented by a promissory note or such other legal documentation as Company's manager deems appropriate. Each loan will be secured by a mortgage. The manager will identify lending opportunities, execute the loans, and manage the loan portfolio.

As the sole member of Company, Entity will be allocated all Company profits and losses and will receive all distributions from Company. Upon the Company's dissolution, and after the satisfaction of its legal obligations, all of Company's remaining assets will be distributed to Entity. Entity will bear all risk of loss from Company, limited to the amount of its capital contributions.

## LAW AND ANALYSIS

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are

desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the income of an organization formed, funded, and operated by political subdivisions to pool various risks arising from their obligations regarding public liability, workers' compensation, or employees' health is excludable from gross income under § 115. In this ruling, private interests did not materially participate in the organization, nor did they benefit more than incidentally from the organization.

Company enables Entity to invest a portion of the trusts, operating funds, capital funds, and property of State and to engage in certain investment strategies, while limiting Entity's exposure to the risks of such investments. Providing such means for investing public assets and for limiting investment risk constitutes the performance of essential governmental functions. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

All of Company's income accrues to Entity, an agency of State. Entity is allocated all Company profits and losses and receives all Company distributions. No private interests participate in, or benefit from, the operation of Company other than as providers of goods or services. The benefit to third-party borrowers is incidental to the public benefit. Upon Company's dissolution, and as long as Entity is a member of Company, no assets remaining after winding up will be distributed to any entity other than a state, a subdivision of a state, or an entity the income of which is excluded from gross income under § 115. See Rev. Rul. 90-74.

#### RULING

Based solely on the facts and representations submitted by the Taxpayers, we conclude that the income of Company is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Consequently, we rule that, as long as Entity is a member of Company, Company's income is excludable from gross income under § 115(1).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code.

Under a power of attorney on file with this office, we are sending copies of this letter to your authorized representatives.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT  
Assistant Chief  
Exempt Organizations Branch  
Office of Division Counsel /  
Associate Chief Counsel  
(Tax Exempt & Government Entities)

enclosures: copy for § 6110 purposes